DISTRICT OF COLUMBIA
OFFICE OF ADMINISTRATIVE HEARINGS
825 North Capitol Street NE, Suite 4150
Washington, D.C. 20002
TEL: (202) 442-9094
FAX: (202) 442-4789

POWELL GOLDSTEIN, LLP Petitioner, v. OFFICE OF TAX & REVENUE Respondent	Case No.: TR-C-05-800044

FINAL ORDER

I. INTRODUCTION

On November 29, 2005, Petitioner filed a *Taxpayer's Protest of a Proposed Assessment*, challenging Respondent's assessment of a deficiency, interest and penalties for the District of Columbia Arena exaction for tax years 1995 through 2001. Respondent filed a Motion for Summary Judgment on February 24, 2006 ("Respondent's Motion"); Petitioner filed a Cross-Motion for Summary Judgment on March 14, 2006 ("Petitioner's Cross-Motion"). These proceedings were then adjourned at the request of the parties so that resolution of this case would be informed by the District of Columbia Court of Appeals decision in *District of Columbia, v. Kenneth Bender, et al.*, 906 A.2d 277 (D.C. 2006). The *Bender* decision was issued on August 24, 2006. Respondent filed its Opposition to Petitioner's Cross-Motion on September 29, 2006 ("Respondent's Opposition"), and Petitioner filed its Reply to Respondent's Opposition on October 16, 2006 ("Petitioner's Reply").

The Rules of this administrative court provide that parties may file motions for summary adjudication or comparable relief. OAH Rules 2812, 2824 and 2828. The Rules also state that "[w]here a procedural issue coming before this administrative court is not specifically addressed in these Rules, this administrative court may rely upon the District of Columbia Superior Court Rules of Civil Procedure as persuasive authority." OAH Rule 2801.2. A motion for summary judgment "shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." SCR Civil - 56 (c).

The Rules of Civil Procedure also provide that:

> there shall be served and filed with each motion for summary judgment … a statement of the material facts numbered by paragraphs as to which the moving party contends there is no genuine issue …. In determining any motion for summary judgment, the Court may assume that the facts as claimed by the moving party are admitted to exist without controversy except as and to the extent that such facts are asserted to be actually in good faith controverted in a statement filed in opposition to the motion.

SCR Civil - 12-I (k).

Therefore, in ruling on a motion for summary judgment,

> [t]he focus of [the court's] inquiry is twofold: first, we look to see if the moving party has met its burden of proving that no material fact remains in dispute, and then we also must determine whether the party opposing the motion has offered competent evidence admissible at trial showing that there is a genuine issue as to a material fact. The burden on the nonmoving party is that sufficient evidence supporting the claimed factual dispute be shown to require a jury or judge to resolve the parties' differing versions of the truth at trial.

Sanchez v. Magafan, 892 A. 2d 1130, 1132 (D.C. 2006) (citation omitted).

Accordingly, the first inquiry for this administrative court is whether there is a genuine issue as to a material fact. In addressing this question, the court is required to view the record in the light most favorable to the non-moving party. *Settles v. Redstone Dev. Corp.*, 797 A.2d 692, 694 (D.C. 2002). The parties have agreed that there is no genuine issue of material fact and that this matter "may be decided on Summary Judgment." Petitioner's Reply, page 2. I concur with this assessment. Even though there are cross motions for summary judgment before me, as the Government was the moving party initially, I have decided to view the record in the light most favorable to Petitioner.

II. FINDINGS OF FACT[1]

1. On June 27, 2005, after a review of Petitioner's books and records, the Office of Tax and Revenue ("OTR") issued a Notice of Proposed Audit Change ("NPAC"), notifying Petitioner that it had failed to file Arena exaction returns (form FR-1000) or pay the Arena exaction for the years 1995 through 2001. *See* D.C. Code, 2001 Ed. § 47-2752(a). Petitioner's Cross-Motion, pages 3-4.

2. In accordance with the NPAC, on July 21, 2005, Petitioner filed a request for an Informal Conference to dispute the proposed audit change. Petitioner's Cross-Motion, page 4.

3. On September 14, 2005, the Informal Conference was convened. Petitioner argued that it was unaware of the existence of the Arena exaction. Petitioner also argued that the Fee years at issue are beyond the three-year statute of limitations, such that the Arena exaction can no longer be collected. Petitioner's Cross-Motion, page 4.

[1] The following facts are not in dispute. *See* Petitioner's Cross-Motion, pages 3-5, and Respondent's Opposition, page 4.

4. As a result of the Informal Conference, a Notice of Proposed Assessment of Tax Deficiency ("NPATD") sustaining the NPAC was issued on November 3, 2005. Petitioner's Cross-Motion, page 4.

5. On November 29, 2005, Petitioner timely filed a protest with the Office of Administrative Hearings appealing the decision of the NPATD. Petitioner's Cross-Motion, page 4.

6. The total amount in dispute, including the Arena exaction, deficiency interest, and the penalties, is $171,341.50 (as of April 5, 2006). Respondent's Opposition, page 4.

7. Petitioner timely filed District of Columbia tax form, D-65, Partnership Return of Income for each of the years 1995 through 2001. Petitioner's Cross-Motion, page 5, and Respondent's Opposition, page 4.

8. Petitioner is a law firm organized as a limited liability partnership, based in Atlanta, Georgia. Petitioner's Cross-Motion, page 5, and Respondent's Opposition, page 4. Petitioner is subject to the District of Columbia Unemployment Compensation Act. D.C. Code, 2001 Ed. § 51-101 *et seq*. However, Petitioner is not subject to the unincorporated business tax ("UB tax"). D.C. Code, 2001 Ed. § 47-1808.01.

III. CONCLUSIONS OF LAW

The parties are in agreement that there are essentially two issues before this administrative court:

A. Whether Petitioner was required to file Arena exaction Form FR-1000, and pay the Arena exactions for the years 1995 through 2001? If so,

B. Whether the statute of limitations protects Petitioner from payment of the Arena exaction, interest, and penalties for the years 1995 through 2001?

I will address each issue in turn.

A. Whether Petitioner was required to file Arena exaction Form FR-1000, and pay the Arena exactions for the years 1995 through 2001?

Petitioner asserts that it was not required to file Arena exaction form FR-1000 or pay the Arena exaction, because the Arena exaction taxes the personal net income of non-District of Columbia resident members of a professional partnership. As such, Petitioner contends the Arena exaction violates the Home Rule Act prohibition against the Council of the District of Columbia imposing "any tax on the whole or any portion of the personal income, either directly or at the source thereof, of any individual not a resident of the District" (one component of Petitioner's argument is that the Arena "Fee" is actually a tax). D.C. Code, 2001 Ed. § 1-206.02(a)(5).

The District maintains that the Arena exaction is in fact a fee (as compared to tax) that does not violate the Home Rule Act, because fees are not covered by the above-referenced provision of the Home Rule Act. Further, even if the Arena exaction is determined to be a tax, the exaction is "based upon annual District [of Columbia] gross receipts of a feepayer" (as compared to personal income). *See* D.C. Code, 2001 Ed. § 47-2752(a-1)(1). The District acknowledges that Petitioner is an unincorporated partnership that falls within an exception to the UB Tax. However, the Government argues that Petitioner falls within the ambit of the Arena exaction, because Petitioner is subject to the District of Columbia Unemployment Compensation Act (D.C. Code, 2001 Ed. § 51-101 *et seq*.). D.C. Code, 2001 Ed. § 47-2751(2)(A)(iii).

Whether Petitioner was required to file form FR-1000 and pay the Arena exaction depends on these two questions: 1) is the Arena exaction a tax or a fee; and 2) if the Arena exaction is a tax, is it an impermissible UB tax, if levied against Petitioner? I will address each question in turn.

1. Is the Arena Exaction a Tax or a Fee?

The parties have expended a great deal of time arguing the question whether the Arena exaction is a tax or a fee, and, if it is a tax, whether it is a gross receipts tax or a net personal income tax. The parties correctly identify this as a threshold question, because, as essentially conceded by Petitioner, if the Arena exaction is a fee (as compared to a tax), it would be liable for the NPATD ("if all taxes were merely called 'fees' that would be an easy way for Respondent to avoid Congress' limitations over Respondent's taxing authority"). Petitioner's Reply, page 9. The Court of Appeals has provided guidance regarding how best to untie this Gordian knot. "To determine whether a particular charge is a 'fee' or a 'tax,' the general inquiry is to assess whether the charge is for revenue raising purposes, making it a 'tax,' or for regulatory or punitive purposes, making it a 'fee.'" *District of Columbia v. Eastern Trans-Waste of Maryland, Inc.*, 758 A.2d 1, 11 (D.C. 2000).

According to the Council of the District of Columbia, "the purpose of the arena tax is to finance the reimbursement of certain predevelopment costs borne by the District government in the development of a downtown arena, including the acquisition of real property needed for the arena site, the demolition of buildings located on the arena site and the relocation of District government employees from those buildings."[2] Notice of Public Roundtable: Bill 11-214, the

[2] While the name of an exaction is not necessarily dispositive on the question at hand; it is interesting to note that the Council of the District of Columbia has labeled the charge at issue a "tax." Bill 11-214, 1995 Council of the District of Columbia, (D.C. 1995)

"Arena Tax Payment and Use Amendment Act of 1995", (June 30, 1005). In that vein, Gilbert DeLorme, Chair of the Greater Washington Board of Trade District of Columbia Political Action Committee, noted that "[d]espite some criticisms from those who claim that the investment will not have any implications for them, the economic analysis clearly shows that there will be dramatic, positive impacts throughout the District's economy." *Testimony of Gilbert DeLormis Before the DC Council Regarding Bill 11-214, the Arena Tax*, June 30, 1995. There is testimony from other business leaders that also notes that the economic impact of the arena will be District wide.

Hence, the purpose of the Arena exaction was for raising the revenue required to support the pre-development costs borne by the District Government in support of the arena construction project. The process of recouping the costs related to the development of the downtown area has neither an apparent regulatory function, nor a punitive or penalizing function. Thus, from the single inquiry of the purpose of the Arena exaction, a conclusion that the charge is a tax as compared to a fee is warranted.

However, in *E. Trans-Waste of Md.*, the Court acknowledged that the aforementioned standard can be ambiguous when applied to a charge that is designed to both raise revenue and regulate an industry. Thus, the Court determined that it was useful to apply a three-part test "that looks to different factors." *E. Trans-Waste of Md.*, 758 A.2d at 11, citing *Valero Terrestrial Corp. v. Caffrey*, 205 F.3d 130, 134 (4th Cir. 2000) (citations omitted). While the Arena exaction contains no obvious regulatory function, even if the three-part test set forth in *E. Trans-Waste of Md.* is applied, the conclusion that the Arena exaction is a tax remains unchanged. The three-part test in question instructs courts to examine: "(1) what entity imposes the charge; (2) what population is subject to the charge; (3) what purposes are served by the use of the monies

obtained by the charge." *E. Trans-Waste of Md.*, 758 A.2d at 11, citing *Valero*, 205 F.3d at 134. The Court went on to say "if the legislature imposes the charge, it is generally considered a tax, but if an administrative agency imposes the charge, it is usually considered to be a fee." *E. Trans-Waste of Md.*, 758 A.2d at 11.

As it relates to the first prong in this test, there is no argument the Council of the District of Columbia enacted the Arena exaction. The exaction is statutory in nature, as compared to a regulatory charge enacted by an administrative agency of the executive branch. Thus, according to the Court's analysis in *E. Trans-Waste of Md.*, this prong supports the conclusion that the Arena exaction is more likely a tax than a fee ("if the legislature imposes the charge, it is generally considered a tax . . ."). *Id*.

The second prong involves whether the assessment "targets only a narrow class of people."[3] *E. Trans-Waste of Md.*, 758 A.2d at 12. Here, Respondent asserts because the Arena exaction applies only to those with gross receipts of more than $2 million, the subjected group is a sufficiently narrow one, "as to suggest the Arena exaction is a 'fee.'" Respondent's Opposition to Petitioner's Cross Motion for Summary Judgment, p. 21. However, Respondent's analysis of the second prong is not completely historically accurate. Prior to Tax Year 2000, all taxpayers subject to the D.C. corporation franchise tax, the D.C. unincorporated business franchise tax, or the D.C. Unemployment Compensation Act, were subject to the Arena exaction (*see* Arena exaction Return 1995, Respondent's Exhibit E). Even those taxpayers who had gross receipts of $0 were still required to pay a $25 Arena exaction according to the Arena Return Fee Schedule. *Id*. In 1999, D.C. Code, 2001 Ed. § 47-2752 was amended by the "Tax Parity Act of 1999," to

[3] *E. Trans-Waste* also states that "standing alone, the fact that an assessment targets only a narrow class of people is not enough to characterize the assessment as a fee." (Citations omitted). *E. Trans-Waste*, 758 A.2d at 26.

inter alia, "eliminate the Arena exaction for businesses with gross receipts under $2,000,000," beginning June 15, 2000. D.C. Code, 2001 Ed. § 47-2752(b-1). Further, the Arena exaction was repealed effective Fiscal Year 2001. Council of D.C., Res. 14-56, (D.C. 2001). Therefore, it was only during Tax Year 2000, that the Arena exaction was targeted to those taxpayers earning more than $2 million in gross receipts. Thus, the Arena exaction cannot be characterized as a fee under this prong.

The third prong of this test was deemed critical by the Court of Appeals. The Court ruled that when "the assessment falls near the middle of the spectrum between a regulatory fee and a classic tax, the predominant factor is the revenue's ultimate use. If the ultimate use of the revenue benefits the general public then the charge will qualify as a 'tax,' while if the benefits are more narrowly circumscribed then the charge will more likely qualify as a 'fee.'" *E. Trans-Waste of Md.*, 758 A.2d at 26 (citations omitted). In *East Trans-Waste of Md.*, the Court held the "solid waste facility charge would benefit the general public more than those who handle trash, recyclables and solid waste." *East Trans-Waste of Md.,* 758 A.2d at 12. Further, the "'revenue's ultimate use as a benefit shared by the public and not just the waste disposal facilities indicates that the [charge] here is a tax.'" *East Trans-Waste of Md.,* 758 A.2d at 12 (citing *American Landfill, Inc. v. Stark/Tuscarawas/Wayne Joint Solid Waste Mgmt.*, 166 F.3d 835, 839-840 (6th Cir. 1999)).

In this case, the Arena exaction will benefit the general public more than those who own the arena. In other words, revenues from the Arena exaction ultimately create a "benefit shared by the public," not an individual benefit for a private stadium owner, thereby underscoring the notion that this "indicates the charge…is a tax." *American Landfill,* 166 F.3d at 839. The Arena exaction was imposed despite the complaints of business owners who were not situated near the

arena and who would not, as the argument goes, see the benefits of the development spurred by the new stadium. However, supporters favoring the Arena exaction, including members of the Council of the District of Columbia, argued that significant benefits to the overall community would flow from the stadium construction and funding to offset the costs to the Government (another "benefit shared by the public") was required. These benefits included: new jobs, new spending, the catalytic effect for economic development in the Gallery Place vicinity, civic pride, new and increased tourism (especially from those who reside in the suburbs and surrounding areas), increased tax revenues through an increased tax base, revitalization, and greater safety for the residents in the Downtown area, etc. Public Roundtable on Bill 11-214: the "Arena Tax Payment and Use Amendment Act of 1995", Committee of the Whole (Jun. 30, 1995). Thus, the third prong also prompts the conclusion that the Arena exaction is a tax.

The "fee" versus "tax" issue has also been addressed in cases involving other types of industries. These cases add the element of the "voluntariness" of the fee or tax at issue. For example, the United States Supreme Court ruled:

> Taxation is a legislative function, and Congress, which is the sole organ for levying taxes, may act arbitrarily and disregard benefits bestowed by the Government on a taxpayer and go solely on the ability to pay, based on property or income. A fee, however, is incident to a voluntary act, e.g. a request that a public agency permit an applicant to practice law or medicine or construct a house or run broadcast station. The public agency performing those services normally may exact a fee for a grant which, presumably, *bestows a benefit on the applicant, not shared by other members of society* (emphasis added).

Nat'l Cable Television Ass'n v. United States, 415 U.S. 336, 340-41 (1974).

In reference to the *Nat'l Cable* decision, the United States Court of Appeals for the Sixth circuit ruled that "the test has been variously stated, but the chief distinction is that a tax is an exaction for public purposes while a fee relates to an individual privilege or benefit to the payer." *United States v. River Coal Co., Inc*, 748 F.2d 1103, 1106 (6th Cir. 1984). In *River Coal*, a "reclamation fee" was imposed on mining operators, for deposit in a fund used for 'reclamation and restoration of land and water resources adversely affected by past coal mining.'" *River Coal*, 748 F.2d at 1106. The court held the reclamation fee had "the essential characteristics of a tax…," as it was an "involuntary exaction for a public purpose." *River Coal,* 748 F.2d at 1106.

Under this analysis, the Arena exaction appears to be a tax. In paying the Arena exaction, the taxpayer does not voluntarily pay a fee to receive an individual benefit or privilege. Rather, the taxpayer pays a tax based on its gross receipts, the revenues of which will go to the District for repayment of the costs associated with the pre-development work required to build the new sports arena. In other words, taxpayers involuntarily must pay this tax for the purpose of raising revenue for the articulated public purposes. Further, such revenue will be used to benefit not only the owners of the sports arena, but will be shared with the surrounding community.

Thus, under both the *East Trans-Waste of Md.* three-part test and under the analysis set forth in *Nat'l Cable Television*, the Arena exaction is most akin to a tax, not a fee. Therefore, I conclude that the Arena exaction was a tax and not a fee.

2. As the Arena Exaction is a Tax, Is it an Impermissible Unincorporated Business Tax, if Levied Against Petitioner?

Petitioner argues that the Arena exaction is an impermissible UB tax, because: i) Petitioner's income is earned through the provision of professional services by mostly non-resident partners; and ii) the Arena tax, assessed on Petitioner's income, is therefore an

impermissible tax on the net personal income of these non-resident partners. The District argues that the Arena tax is by statute, the regulatory scheme, and practice assessed on the basis of the gross income of the affected businesses; hence it is not an impermissible UB tax.

The District of Columbia Court of Appeals has issued certain decisions that the parties argue have a direct bearing on the outcome of this case. Specifically, these cases are: *Bishop v. District of Columbia*, 401 A.2d 955 (D.C. 1979) ("*Bishop I*"); *Bishop v. District of Columbia*, 411 A.2d 997 (D.C. 1980) (en banc decision) ("*Bishop II*"); and *District of Columbia v. Bender*, 906 A.2d 277 (D.C. 2006) ("*Bender*"). Of course, both parties assert that other cases suffuse the analysis applicable herein (at least tangentially), and they are correct. The UB tax allows for the taxation of nonresident professional's personal income, under certain circumstances. D.C. Code, 2001 Ed. § 47-1808.01, *et. seq*. The *Bishop* and *Bender* decisions pertain to how and why the District Government is allowed to tax the net personal income of nonresidents via the UB Tax. In the *Bender* decision, the Court of Appeals set forth a detailed history of the laws associated with implementation of the UB tax, so I will not attempt to recount that history herein. *Bender*, 906 A.2d at 279-281.

It is helpful to begin this analysis by looking at how many of the relevant terms are defined in local law. The District of Columbia defines "income tax" as:

> A tax imposed on or measured by *net income* including any tax imposed on or measured by an amount arrived at by deducting expenses from gross income, one or more forms of which expenses are not specifically and directly related to particular transactions.

D.C. Code, 2001 Ed. § 47-441, Art. II.4 (emphasis added).

While a "gross receipts tax" is defined as:

> A tax other than a sales tax, which is imposed on or measured by the *gross volume of business*, in term of gross receipts or in other terms, and in the determination of which *no deduction* is allowed which would constitute the tax an income tax.

D.C. Code, 2001 Ed. § 47-441, Art. II.6 (emphasis added).

For purposes of the Arena tax, the term "gross receipts" is defined as "all income, derived from any activity whatsoever from sources within the District, whether compensated in the District or not, *prior to the deduction of any expense* whatsoever connected with the production of such income. . . " (emphasis added). D.C. Code, 2001 Ed. § 47-2751(1).

In *Bishop I*, the Court of Appeals concluded that the action of the Council of the District of Columbia to eliminate a Congressionally-created exception to application of the unincorporated business tax violated the Home Rule Act. *Bishop 1*, 401 A.2d at 960-961. Specifically, the Court of Appeals ruled:

> The tax is levied upon personal income. If we dealt here with a corporate franchise tax, the result would be different. To the extent that we deal with individuals who are professionals and are not protected by the corporate veil, we must find that the tax burdens the taxpayer personally.
>
> We do not by this opinion mean to imply that the District of Columbia cannot tax nonresident professionals who operate an unincorporated business. We say only that the District of Columbia cannot tax the net personal income of nonresidents.
>
> For the above reasons, we conclude that the professional tax here at issue is an invalid exercise of the City Council's legislative authority under the Home Rule Act.

Bishop 1, 401 A.2d at 961.

The Court of Appeals reached this conclusion after an exhaustive analysis of the history of the governing laws and the purpose of the statute in question. In *Bishop II*, the Court of

Appeals, acting *en banc*, noted that the division "held that the resulting tax on unincorporated professionals was not a franchise or gross receipts tax, but rather a tax levied upon the personally income of. . . ." individuals. *Bishop II*, 411 A.2d at 998. Thus, the *en banc* decision upheld the division's opinion.[4] The important point in both decisions was that the Council had passed legislation that "circumvented the intention of Congress, as stated in the Home Rule Act. . . ." *Bishop II*, 411 A.2d at 998.

In *Bender*, the Court of Appeals faced a very different question, because although it concerned a tax of nonresident personal income derived through an unincorporated business, the tax fell squarely in line with the Congressionally-approved taxing authority of the Council. By comparison, as noted above, the Court of Appeals had characterized the "problem in *Bishop* was that the Council had exceeded its power conferred by Congress by actually purporting to repeal the Congressionally imposed 'professional services' limitation" on the UB Tax. *Bender*, 906 A. 2d at 283 (emphasis added). The Court of Appeals ruled in *Bender*, "unlike the exclusion for personal services income, the Tax Act of 1947 specifically allowed for the taxation of nonresident personal income that is derived from the operation of an unincorporated business with the District of Columbia." *Bender*, 906 A.2d at 283-284. The guidance to be drawn from these decisions is that the Government, by way of the UB tax, has the right to tax the personal income of nonresident operators of an unincorporated business, so long as that exaction is not applied to the Congressionally-created "professional services" limitation.

Moreover, the Court of Appeals has recognized that there are circumstances when a tax may be applied to unincorporated businesses (as compared to the operators of the business) that

[4] Actually, the division's opinion in Bishop I had been vacated by the *en banc* Court in June 1979, and reinstated upon issuance of the decision in Bishop II in February 1980.

fall within the professional services limitation, even if the tax is measured on the basis of income. In *Bishop II*, the Court of Appeals acknowledged that a tax "levied on any act of earning income" and measured by the gross income earned, may be an acceptable means to tax unincorporated professional services businesses in the District of Columbia. *Bishop II*, 411 A.2d at 999. This analysis elucidated a passage in the panel decision in *Bishop I*, which noted

> [a] tax on gross receipts is not the same as a tax on net income. The former contemplates an annual levy on the total receipts of the taxpayer, regardless of the cost of attaining those receipts. The latter denotes gross income less certain deductions.

Bishop I, 401 A.2d at 959.

In the *Bishop* cases, the Government argued that the tax in question was nothing more than a tax on the right to earn an income in the District of Columbia. The Court of Appeals rejected that contention by noting that:

> [a]ppellee would have us hold that this tax is a tax on the right to earn income in the District, measured by the amount of income earned, and nothing more. That argument would be persuasive if the incident of this tax were the right to do business. Were such the case, the tax would be levied upon any act of earning income, regardless of any other consideration.

Bishop I, 401 A.2d at 960.

The Court of Appeals explained this further by noting:

> a nonresident could earn substantial income within the District, but because of business expenses, medical expenses, interest payments, and the like, pay very little tax, it cannot be said that the tax falls solely on the right to earn income within the District.

Bishop I, 401 A.2d at 960-961.

Thus, as I have decided that the Arena exaction is a tax, the question becomes whether the tax is a gross receipts tax or a net personal income tax. As noted above, the Court of Appeals has provided guidance on how to determine if a tax is a gross receipts or net personal income tax. The primary difference being a gross receipts tax falls of the total income earned, without consideration for the cost of earning that income, which, in a net personal income tax scenario, would be deductible from income before the tax is assessed.

The Court of Appeals has provided additional guidance on how to answer this question by noting: "the Supreme Court…has unmistakably determined that taxes imposed on subjects other than income, e.g. franchises, privileges, etc., are not income taxes, *although measured on the basis of income.*" *Bishop I*, 401 A.2d at 960 (quoting *Keasbey & Mattison Co. v. Rothensies*, 133 F.2d 894 (3rd Cir. 1943) (emphasis added)).

Of course, as Petitioner argues, it is not the definitions of the terms and the label of the exaction *per se* that determines whether the Arena tax is a gross receipts or net personal income tax. Thus, it is also fair to examine how the Government is administering the Arena tax. In that regard, Federal and District tax returns (IRS Form 1065 and D-65), as well as the Arena exaction forms, instructions and regulations all provide information necessary to answer the question.

District gross receipts are calculated by adding the total income as reported on line 8 of federal Form 1065, plus the cost of goods sold and the cost or basis of property sold.[5] This figure is then multiplied by one of the allowable apportionment factors. The sum of which is the "District gross receipts." The taxpayer is liable for the tax based on the District gross receipts. The instructions also note that "D.C. gross receipts are all income derived from sources in the

[5] See FR-1000, Arena Fee Return instructions.

District, whether compensated in the District or not, before the deduction of any expense connected with income production, except returns and allowances." FR-1000, Arena Fee Specific Instructions (emphasis added). This is distinct from the unincorporated business tax discussed in *Bishop*, which, again, was based on the taxpayer's "*net income* derived from sources within the District." *Bishop*, 401 A.2d at 960 (quoting D.C. Code, 2001 Ed. § 47-1808.02).

Although the Arena tax is measured on the basis of income, it is neither a net personal income tax as defined in D.C. Code, 2001 Ed. § 47-441, nor as defined in *Bishop*, 401 A.2d at 959.[6] The Arena tax is based on a threshold amount of gross receipts and is determined prior to taking any deductions for costs or expenses connected with income production. As the court in *Bishop* explicitly stated:

> We do not by this opinion mean to imply that the District of Columbia cannot tax nonresident professionals who operate an unincorporated business. We say only that the District of Columbia cannot tax the *net personal income* of nonresidents (emphasis added).

Bishop, 401 A.2d at 960.

Petitioner argues that the Arena tax is a charge to the net personal income of the nonresident partners that make up its business organization. Petitioners contend that because the income of the partnership is taxed "prior to distribution to the partners . . . the distribution is lower and the impact is that the partners were taxed on the net income before it was even distributed to them." Petitioner's Reply at 8. But this is the very flaw in Petitioner's argument. The income is taxed before it is distributed to the partners, it is taxed before deductions for the cost of income production are taken into consideration; hence by the analysis proffered by Petitioner, the Arena tax is assessed before the very acts occur that would transform the income

[6] *See Keasbey & Mattison Co. v. Rothensies*, 133 F.2d 894 (3d Cir. 1943) quoted in *Bishop*, 401 A.2d 955 (D.C. 1979).

in question from partnership gross receipts to personal net income.[7] Therefore, I conclude the Arena tax is a charge against Petitioner's gross receipts and is not an impermissible UB tax.

B. Whether the Statute of Limitations Protects Petitioner from Payment of the Arena Tax, Interest, and Penalties for the Years 1995 Through 2001?

Petitioners argue that the statute of limitations "has clearly run on all years in issue." Petitioner's Reply, page 13. Petitioner rest its argument on the fact that the applicable statute of limitation is three years and that it timely filed its Partnership Return forms (D-65) during the years in question (which put the District on notice of its potential liability for the Arena tax), and that Petitioner was obligated to file no other tax "return" in order to trigger the statute of limitations.[8] The District counters by arguing that the statute of limitations had not even began to run, because the filing of form D-65 was not the triggering event, rather, it would have been the filing form FR-1000, which Petitioner has never filed. D.C. Code, 2001 Ed. § 47-4301 (d).

D.C. Code, 2001 Ed. § 47-4301 sets forth the periods of limitation for Title 47 proceedings as follows:

> (a) Unless otherwise provided in subsection (d) of this section, the amount of a tax imposed under this title shall be assessed within 3 years after the return was filed…A proceeding in court without assessment for the collection of the tax shall not commence after the expiration of such period. For purposes of this chapter, the

[7] Petitioner actually carefully notes that the Arena tax is not a direct charge against the net personal income of the partners, but rather it has that "effect." Petitioner's Reply at 8.

[8] There is disagreement between the parties as to which statute of limitations is applicable. In 2000, D.C. Code, 2001 Ed. § 47-1812.10 was repealed by the Tax Clarity Act of 2000, and replaced with D.C. Code, 2001 Ed. § 47-4301. Respondent asserts the governing statute of limitations is § 47-1812.10, while Petitioner argues the governing statute is § 47-4301. Under the Tax Clarity Act of 2000, Section 410 states "except as otherwise provided therein, sections 403 and 404 shall apply to taxes…for all tax years or taxable periods beginning after December 31, 2000." D.C. Act 13-501 (Dec. 13, 2000). However, for the purposes of determining whether Respondent may make an assessment of tax, both provisions have the same effect.

> term "return" means the return of tax required to be filed by the taxpayer.
>
> (d) In the case of (C) failure to file a return, the tax may be assessed, or a proceeding in court for the collection of the tax may begin without assessment at any time.

D.C. Code, 2001 Ed. § 47-4301.

In *Germantown Trust Co. v. Comm'r of Internal Revenue*, 309 U.S. 304, 305 (1940), Appellant was a trust company that created an investment fund for its customers. Appellant paid the participants their share of the investment income, and filed fiduciary returns of income. *Germantown Trust Co.*, 309 U.S. at 305. The fiduciary return "set forth the gross income, the deductions, and the net income, -- in short all information necessary to the calculation of any tax which might be due, -- and attached a list of the beneficiaries of the fund, and their shares of the income. No corporation income tax return was filed on Treasury Form 1120." *Germantown Trust*, 309 U.S. at 305. Each participant then included their shares of income on their individual tax returns for the year 1932. *Germantown Trust*, 309 U.S. at 305.

In September 1936, a treasury agent decided the fund in question should be taxed as a corporation, not as a trust. *Germantown Trust*, 309 U.S. at 305. The Internal Revenue Commissioner prepared a substitute corporate return for the year 1932, and gave notice of a tax deficiency to Appellant in February 1937. *Germantown Trust*, 309 U.S. at 306. The applicable statute of limitations was found in the Revenue Act of 1932, section 275, where "except as provided in Section 276" the general rule for the assessment of taxes was:

> (a) The amount of income taxes imposed by this title shall be assessed within *two years* after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * *

> (c) *Corporation and Shareholder. – If a corporation makes no return of the tax imposed by this title,* but each of the shareholders includes in his return his distributive share of the net income of the corporation, then the tax of the corporation shall be assessed within *four years* after the last date on which any such shareholder's return was filed. (Italics in original).

However, section 276 stated an exception to the general rule:

> (a) *False Return or No Return.* – In the case of a false or fraudulent return with intent to evade tax *or of a failure to file a return*, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

Revenue Act of 1932, 47 Stat. 169, 237 (quoted in *Germantown Trust*, 309 U.S. at 306) (emphasis added).

In *Germantown Trust*, Appellee asserted that because Appellant filed a fiduciary return, as compared to a corporate return (which the Commissioner argued was the required form), Appellant should be viewed as having, in effect, filed no return (such that the statute of limitations had not been triggered); or, as a corporate return was actually required, the applicable statute of limitations should be deemed four years (relying on section 275 (c) *supra*), not two years. *Germantown Trust*, 309 U.S. at 309. Thus, the argument goes, that, at a minimum, as assessment of the tax deficiency was initiated within four years of the filing of the fiduciary return, the collection effort could proceed. The Court held, however, that 275(c) was not applicable to the case because of the unique circumstances surrounding the enactment of the Revenue Act of 1932. Further, the Court declared that "it cannot be said that the petitioner, whether treated as a corporation or not, made no return of the tax imposed by the statute. Its return may have been incomplete in that it failed to compute a tax, but this defect falls short of rendering it no return whatever." *Germantown Trust*, 309 U.S. at 310. The Supreme Court

concluded therefore, that the statute of limitations began to run once the fiduciary form had been filed by Appellant. *Germantown Trust*, 309 U.S. at 310.

Both parties argue that the holding in *Germantown*, when viewed in isolation, supports Petitioner's position; namely that upon filing form D-65, the statute of limitations was triggered, and that the three year statute of limitations has run, thereby precluding the District from pursuing the deficiency in question.[9] Petitioner's Cross-Motion at page 12; and Respondent's Opposition at page 30. However, as set forth below, it appears that both parties have misread the *Germantown* decision.

Nonetheless, in *Comm'r of Internal Revenue v. Lane-Wells Co.*, 321 U.S. 219 (1944), the Supreme Court distinguished *Germantown Trust* on the basis of the fact that in *Germantown Trust* the taxpayer had to satisfy one tax liability and, attempting to address that liability, simply filed the wrong tax form (which actually contained all of the information required to assess the appropriate tax). *Lane-Wells*, 321 U.S. at 221. In comparison, in *Lane-Wells*, the taxpayer was liable for *two* taxes, and had an obligation to file *two* returns (one for each of the disputed taxes). *Lane-Wells*, 321 U.S. at 223. The Court in *Lane-Wells* held that "since no personal holding company returns were filed, the statute of limitations did not commence to run, and the assessment of [that] tax was not barred." *Lane-Wells*, 321 U.S. at 224.

As an unincorporated partnership that is not subject to the UB tax, Petitioner is required to file form D-65, to report, at a minimum, the "names and addresses of the individuals who would be entitled to share in the net income of the partnership, if distributed, and the amount of distributive share of each individual." D.C. Code, 2001 Ed. § 47-1805.02(7). The District

[9] The District argues that subsequent Supreme Court decisions negate the salutary effect *Germantown Trust* has on Petitioner's position.

maintains that this allows the Government to cross check and ensure that partners who are residents of the District of Columbia, who have an obligation to declare their partnership income, actually do so. Petitioner concedes that it is required to file form D-65 and, in fact, had filed this form timely during the years at issue. Form D-65 is due when Petitioner's federal tax forms are due (typically on or about April 15). However, the Arena tax has a separate filing requirement. D.C. Code, 2001 Ed. § 47-2751 *et seq*; 9 DCMR Chapter 34. The Arena tax filing required a different form than D-65 and had a different filing deadline (June 15). *Id*.

Therein lies the parties' misunderstanding of the *Germantown Trust* holding; namely neither party discussed the fact that, as noted above, the taxpayer in *Germantown Trust* was liable for only one tax. In the instant case, Petitioner was liable (at least potentially) for no less than two taxes (partnership income and Arena taxes) with two separate forms (D-65 and FR-1000). Thus, even if the Supreme Court had not had occasion to issue the *Lane-Wells* decision, the *Germantown Trust* decision provides no safe harbor for Petitioner given this crucial factual distinction.

Petitioner declares in its pleadings that form D-65 is the return which triggers the statute of limitations. However, besides repeating the statutory provision that says the filing of the return triggers the statute of limitations, Petitioner never explains why the statute of limitations does not apply separately to both the filing of form D-65 and FR-1000. In other words, the statute of limitations for assessing compliance with the requirement to file form D-65 starts three years after that form is filed (if ever) and the statute of limitations for assessing compliance with the requirement to file form FR-1000 starts three years after the filing of that form (if ever). Petitioner's reading of the law requires an unduly narrow reading of the plain language of the statute. I conclude that the statute of limitations for assessing compliance with the Arena tax

requirements is triggered by the filing of FR-1000. Petitioner did file one correct return (D-65), but was required to file a second return (FR-1000) and failed to do so.[10] Thus, because the Arena Fee is a separate tax containing its own filing requirements, and Petitioner failed to file the Arena Fee Return, the statute of limitations has not commenced to run.[11]

Therefore, based on the above Findings of Fact and Conclusions of Law and the entire record in this matter, on this 30th day of April 2007, it is:

ORDERED that Petitioner's Cross-Motion for Summary Judgment is **GRANTED IN PART** insofar as I conclude, as a general proposition, that the Arena exaction is a tax, but the motion is **DENIED IN PART** insofar as I conclude that the Arena tax is not an impermissible unincorporated business tax when levied against Petitioner; it is further

ORDERED that Respondent's Motion for Summary Judgment is **GRANTED IN PART** insofar as I conclude that the Arena tax is not an impermissible unincorporated business tax when levied against Petitioner but **DENIED IN PART** insofar as I conclude, as a general proposition, that the Arena exaction is a tax; it is further

ORDERED that Petitioner is **LIABLE** for the Arena tax, interest and penalties for years 1995 to 2001; and it is further

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[10] I so conclude even though, as Petitioner asserts, Form D-65 "set[s] forth the gross income, the deductions, and the net income, -- in short all information necessary to the calculation of any tax which might be due." *See Germantown*, 309 U.S. at 305.

[11] Petitioner asserts the partnership's "failure to file the Arena Fee was [not] intentional or… negligent" as Respondent implies. Petitioners Reply, p. 12. However, the statute merely states "in the case of (C) failure to file a return, the tax may be assessed, or a proceeding in court for the collection of the tax may begin without assessment at any time." D.C. Code, 2001 Ed. §47-4301(d). Petitioner's intentions are irrelevant, regardless of anything Respondent may have implied. Thus, where no Arena Fee Return was filed, the statute of limitations does not begin to run.

ORDERED that the appeal rights of persons aggrieved by this Order are set forth below.

April 30, 2007

SS
Jesse P. Goode
Administrative Law Judge